

# ***U.S. Embassy - Skopje***

## **ECON NEWSLETTER 06-07/2004**

### **CEFTA ACCEPTS MACEDONIA'S APPLICATION FOR MEMBERSHIP**

The Central European Free Trade Agreement (CEFTA) at the conference in Sofia accepted Macedonia's application for membership, which was submitted in April 2004.

"Macedonia in September is prepared to begin the bilateral experts' meetings with CEFTA member countries, Bulgaria, Romania and Croatia, and to finish them by the end of the year," Minister of Economy Stevco Jakimovski stated at the conference. Jakimovski pointed out that the negotiations on membership would start from the obligations taken over with the Stabilisation and Association Agreement (SAA), Agreement on Association with the European Union and Free Trade Agreements with CEFTA member countries.

The membership in CEFTA will create wider zone for free trade, will deepen the regional cooperation, create conditions for implementation of the European standards in the national, political, economic and legal system.

The Central European Free Trade Agreement was signed on 21 December 1992 in Krakow, Poland. All the signatories had previously signed association agreements with the EU, which is why CEFTA functions as a preparation for full EU membership. Romania, Bulgaria and Croatia are the remaining members after Poland, Hungary, the Czech Republic, Slovakia and Slovenia have joined the EU on May 1, 2004.

### **PARLIAMENT ADOPTED LAW FOR PREVENTION OF MONEY LAUNDERING**

In July, the Parliament has adopted the new Law for prevention of money laundering. According to the law, the identity of a client must be determined in each transaction of Euro 15,000 and more. Savings' houses will have to determine the identity of the clients, exchanging a sum of more than Euro 2,500.

During the discussion, Minister of Finance Nikola Popovski stressed that one of the objectives of this law was to decrease the cash payments for larger amounts of

money. As stated in the text, the law would provide a system of preventive measures and actions against money laundering and financing of terrorism, which will be in accordance with the provisions of international documents and with appropriate systems in developed countries.

#### **GERMAN GRANT OF EURO 5.1 MILLION FOR DEVELOPMENT OF MUNICIPALITIES**

Macedonian Minister of Transport and Communications Agron Buxhaku and German Ambassador to Macedonia Irene Hinrichsen signed an Agreement on the program "Social Infrastructure 3." German Government granted Euro 5.1 million for realization of the program that would improve the communal infrastructure and ecological conditions in the municipalities, and would alleviate the unemployment by creating opportunities for temporary employment in the communal work.

The project encompasses the municipalities Rankovce, Kriva Palanka, Kratovo, Karbinci, Sv. Nikole, Caska, Dolneni, Makedonski Brod, Vevcani, Oslomej and Debar. The Ambassador Hinrichsen said they would make efforts to enable realization of a new "Social Infrastructure 4" project. Over Euro 10 million for 80 projects in 23 municipalities were spent in the previous two phases of the program "Social Infrastructure". The German Government has granted Euro 18.38 million in financial assistance to Macedonia so far.

#### **CENTRAL BANK GOVERNOR RULES OUT INFLATION AND DEVALUATION MEASURES**

In an interview for Utrinski vesnik daily, the Central Bank (CB) Governor Petar Gosev ruled out inflation and devaluation as measures to stimulate the economy. Gosev pointed out that a number of indicators suggested that the monetary policy is not actually restrictive. Thus, M2 rose by 22.2 percent on annual basis at the end of May, while the banks' total investments rose by 23.3 percent.

Gosev said that factors affecting the supply should be blamed for the declining GDP (Note: GDP fell by 3.6 percent in Q1), instead of blaming the monetary policy. He said he did not believe inflation will strengthen the weak local supply. Gosev warned that higher inflation would also cause exchange rate fluctuations which, and in turn may easily cause systemic banking and financial instability.

Gosev also stated that according to the CB estimates the competitiveness of the Macedonian exports has not declined perceptibly since 1997, due to the low local inflation. Thus, a devaluation is not to be expected and the stability of the exchange rate will continue. He also commented that there are no reasons for introduction of a currency board.

#### **GOVERNMENT REPORT TO IMF**

The Ministry of Finance has reported to the IMF the progress on public administration reforms, under which 1,020 persons employed in the public sector should have been laid off by July 15, 2004. Following this cycle, an additional lay off round is expected by the end of 2004, after which the number will increase to a total of 2,200 persons. The Ministry of Finance categorically informs that the reforms will be carried out with no exceptions.

According to the lay off lists, there is a surplus of 1,017 persons in the education sphere, 400 of which have already been laid off, and thus satisfied the requirements of the first cycle. About 230 persons should be dismissed from the Ministry of Interior, 100 from the kindergartens, 98 from the Culture Department, 50 from the Public Revenue Office, 37 from the Geodesy Bureau, 35 from the Customs Administration, 32 from the Ministry of Justice, 28 from the Ministry of Finance, 18 from the Ministry of Economy and 5 from the Ministry of Defense.

#### **CENTRAL BANK CUTS LOMBARD RATE TO 11 PERCENT**

The National Bank of Macedonia (NBM) cut its Lombard rate to 11 percent from 14 percent, to boost banks' investments. The Lombard rate, a monetary tool used as a ceiling for loans to local commercial banks, has been reduced twice in the past year. NBM also increased the allowed daily use of the banks' reserve requirements to 80 percent from the present 60 percent, in an attempt to improve commercial banks' liquidity.

#### **MACEDONIA OBTAINS THREE LOANS FROM WORLD BANK**

Macedonian Minister of Finance Nikola Popovski and the World Bank Resident Representative to Macedonia Sandra Bloemenkamp signed agreements on Public Sector Management Adjustment Loan (PSMAL), Health Sector Management Loan (HSML) and Social Protection Implementation Loan (SPIL), totalling US\$ 49.8 million. Thirty millions will be directed to harmonization of public sector management

(PSMAL), US\$10 million for implementation of social security (SPIL), while the remaining US\$9.8 million will be allocated to the health sector.

The activities undertaken by such loans will have positive influence on the economic and social situation in Macedonia and will support its determination to join the EU, Bloemenkamp stated after signing the agreements. The loans are part of a three-year Country Assistance Strategy, which the World Bank has agreed with the GOM for reform's support.

Popovski announced that he will soon sign the US\$17 million grant provided by the Dutch Government, which is a co-financier of the program. He explained that these loans will serve as support of the balance of payments and will be transferred to the foreign exchange reserves in order to maintain macroeconomic stability.

#### **MACEDONIA TO CUT 2004 ECONOMIC GROWTH TARGET**

GOM will revise down its economic growth target for this year from the current 4.0 percent, following a drop in industrial production. "We will surely see a revision of the GDP target for this year," an official, who declined to be named, told SeeNews. "The government will most probably put a new target which will be up to 2.0 percent or 2.5 percent," the source said. Official statistics showed that Macedonia's economy shrank by 3.6 percent in real terms in the first quarter of 2004 compared to the same period last year, mainly due to the sharp decline in industrial output.

Macedonia's May industrial production index was down by 31.5 percent from the average monthly index for 2003 and was 26.6 percent below the May 2003 figure. Industrial production has been falling since the beginning of the year. Ministry of Economy blamed the drop mainly on delayed privatization and failed attempts to restart key industrial producers.

In a statement sent to SeeNews, the IMF resident representative Kevin Ross said that it had not yet revised its 2004 growth forecast for Macedonia. However, as usual, the mission will continue to review its projection as new information becomes available.

The Ministry of Economy has tasked a working group to examine whether the drop was prompted by inappropriate statistics methodology or by a slowdown in major industry branches. It was expected to present its findings to the

cabinet of the Prime Minister Hari Kostov. Both the IMF and the Ministry of Economy have said that the drop in the industrial production did not match developments in other indicators, such as rising exports and industrial electricity consumption, as well as increasing tax collection.

#### **NEW OWNER OF "SASA" MINE**

Blazo Tasev from Slovenia is the new owner of the lead and zinc mine "Sasa" from Makedonska Kamenica. "Sasa" board of trustees came to this decision, after Tasev's offer was ranked first at the third tender for sale of the mine. Tasev offered Euro 606,000 for the mine. He should pay the money in a 21-day deadline and register a new company according to Macedonian regulations, since he took part in the tender as an individual.

According to the business plan, the Slovenian businessman is obliged to restart mine production in six months, with additional investment of Euro 8,120,000, as well as to bring back to work 900 former employees in "Sasa". Businessman Blazo Tasev originates from the village Ciflik near Kocani. His company in Slovenia "Tabakum" from Novo Mesto trades with batteries and agricultural mechanization.

#### **MACEDONIA GRADED POSITIVELY BY STANDARD & POOR'S**

The Republic of Macedonia received positive grades in its first international credit rating after declaring independence. On July 30, 2004, the famous monitoring and rating house, Standard and Poor's, gave Macedonia BB/B foreign currency and BB+/B local currency sovereign credit ratings.

This ranking is considered as exceptionally favorable because Macedonia hasn't had a rating so far. The international evaluation on Macedonia's ability to meet financial obligations both in domestic frames with denar payments and transactions abroad with foreign creditors, provides a wider evaluation on the capability of business subjects in the country. The evaluation is also highly important for attraction of foreign investments and further approach to the European Union.

According to the explanation remarks provided by Standard & Poor's, Macedonia's favorable credit rating is based on the considerable improvement of its political stability, based on the Ohrid Peace Agreement and the perspectives for EU membership, as well as macroeconomic stability and

checked level of international indebtedness. The evaluators sustain that interethnic relations continue to play a considerable part in determining political stability, confirming the international community's obligations for stabilization of conditions in Macedonia.

On economic plan, "prudent economic policies" keep macroeconomic stability under control, albeit numerous shock blows since independence. Inflation is kept low since the mid-nineties and is expected to rise by 4.2 per cent in the issuing two years. The structural discrepancy in economy and the high level of unemployment persist. The report holds that tax accounts are solid, while trade deficit is extremely high (hitting 18.3 per cent GDP in 2003). Nevertheless, it is smoothly financed by numerous private transfers, grants and relief loans, keeping foreign debt under control.

"In addition to the rating from Standard & Poor's, we expect Moody's Investors Service to award Macedonia a credit rating," Natasa Jovanovska, an official from the Ministry of Finance in charge of the country's credit ratings, told SeeNews. "A credit rating from Fitch Ratings has been discussed but it is expected to be awarded no earlier than next year," she added.

#### **IMF APPROVES FINAL TRANCHE UNDER STAND-BY AGREEMENT WITH MACEDONIA**

The International Monetary Fund (IMF) approved the final disbursement under its current stand-by arrangement (SBA) with Macedonia, noting that the country had promoted fiscal sustainability but economic growth remained fragile.

The Macedonian authorities have achieved the core goal of the economic program they adopted in early 2003 - namely, to promote fiscal sustainability following the 2001 security crisis, IMF Deputy Managing Director Takatoshi Kato said in a statement. Macedonia is now able to use the US\$ 11.7 million tranche under its 14-month SBA amounting to US\$ 29.4 million.

The deal was approved on April 30, 2003 and it was extended to August 15 this year after Macedonia's President Boris Trajkovski was killed in a plane crash in February. However, the Fund warned that economic growth slowed down in early 2004 and this, together with the widening external current account deficit, persistently high unemployment, and narrow export base, was underscoring the need for further reforms. The Fund

advised that Macedonia should complement sound macroeconomic policies with structural reforms aimed at reforming the healthcare sector, bolstering the supervision of the banking and financial sectors, strengthening governance, and improving the business environment to nourish economic growth.

#### **FOREIGNERS INTERESTED FOR PENSION INSURANCE LICENSE**

Slovenia's First Private Pension Fund signed a letter of intent with Komercijalna Banka Skopje for participation at the international tender for obtaining pension insurance license in Macedonia. If they are granted the license, the Slovenians and Komercijalna Banka expect to participate with around 60 percent in the private pension insurance market in Macedonia. They plan to invest 1.5 million euro in the second pension fund in order to secure the controlling stake.

Besides the First Private Pension Fund from Slovenia, allegedly other firms, including Croatia Insurance from Zagreb, Nova Ljubljanska Banka joined by Tutunska Banka from Skopje, NBG Group from Greece and QBE Insurance from Skopje, showed interest in participating at the tender for selection of the second pension pillar. According to regulations, minimum two companies will be awarded with a license at this stage. The international tender for selection of founders of private pension funds, published in a number of worldwide media on June 27, will be closed on September 29, when the identities of all bidders will be revealed.

#### **JAPANESE COMPANY TO CONSULT ON CONSTRUCTION OF ZLETOVICA**

The Japanese Company for providing intellectual services, Pacific Consulting, has the best chances to be selected a consultant for construction of hydroelectric system Zletovica, the management of the public enterprise Zletovica confirmed.

According to enterprise officials, Japanese experts are expected to visit Macedonia for final talks. The Japanese Bank for International Cooperation allocated US\$ 82.5 million for construction of the dam and the water supply pipeline, supposed to serve the purposes of 100,000 residents in seven municipalities in eastern Macedonia. This credit constitutes merely 75 percent of necessary funds.

The money provided should secure the projected construction of an 80-meter high dam and a water supply

pipeline for the municipalities of Stip, Karbinici, Lozovo, and Sveti Nikole. The pipeline to Kratovo has been already completed, while the remainder to Zletovo and Probistip will be financed by the GOM. The second and third phase foresee the construction of three cascade hydroelectric power plants, which are to be financed by concession agreements.

### **30,000 VIRTUAL EMPLOYMENTS IN SIX MONTHS**

Official sources from the Macedonian Employment Bureau inform that the institution registered new, record-high, 31,870 employments from January to July 2004, 19,883 of which are beyond the Bureau's evidence books, implying that the individuals employed were not registered in the list of unemployed persons. This number espouses diverse employments - some are public sector employments, which, in accordance to the legal provisions, are signed in by the Prime Minister and the Minister of Finance, some coincide with employments in public enterprises or private firms, while others present the transfer of persons from one firm to another.

According to PM Hari Kostov, the number of new employment in the year to July, released by the Employment Bureau is not a real representation of conditions.

### **EBRD ADOPTS NEW STRATEGY FOR MACEDONIA**

Macedonia is constantly progressing in its transition toward market economy, but the political insecurity, slow structural reforms, bureaucracy and corruption prevent a more significant growth in the economy, the European Bank for Reconstruction and Development (EBRD) says in its latest Country Strategy for Macedonia.

Some of the major challenges that Macedonia faces, according to EBRD, are improving the business climate for attracting the much needed domestic and foreign investments, reforming the judicial system and dealing with corruption. The strategy supports the positive achievements, including the low inflation, the firm fiscal policy that helped reduce the budget deficit and the significant headway in closing loss-making companies. According to EBRD's report, Macedonia plays the lead role in promoting the regional cooperation in Southeast Europe through political dialogue, inter-regional trade agreements and regional infrastructure connection.

EBRD announces stronger support for the corporate and financial sector, and the infrastructure. The Bank has



so far provided more than 327 million euros for 24 projects in Macedonia. In terms of EBRD's average transition score, in the SEE region Macedonia was ranked behind Croatia, Bulgaria and Romania, but ahead of Moldova, Albania, Bosnia and Herzegovina and Serbia-Montenegro.

#### **SMELTING PLANT TO BE REVITALIZED BEFORE BEING OFFERED FOR SALE**

The Veles smelting plant MHK Zletovo, which went bankrupt, will soon resume production, the creditors from Fersped, Makpetrol and Komercijalna banka say. The three major creditors in the factory agreed to revitalize the company and restart production before announcing an international tender for its sale.

According to the unofficial information, the smelting plant's overall debts to creditors are approximately US\$ 120 million. The bulk of it is owed to Glenkor, which MHK Zletovo used to cooperate with for a long time. Investas, a company affiliated to Glenkor, has until recently managed the facilities of the smelting plant by having taken over a mortgage.

#### **SIGNING OF RENTAL AGREEMENT FOR BUNARDZIK**

Minister of Transport and Communications Agron Buxhaku and chairman of Welsh company Glendor Estate Limited Owen Livelin signed a long-term rental agreement for a building site in the free economic zone of Bunardzik, the Ministry of Transport and Communications informed.

According to the agreement Glendor Estate Limited should manage Bunardzik in the next 50 years with a possibility to prolong the deadline for additional 25 years. Glendor Estate Limited has already obliged to develop 20 percent of the zone in the first five years, 50 percent in 10 years and to develop the zone completely in 15 years. Besides developing the zone, the company should bring at least six world companies, which will invest in Bunardzik in the first year.

#### **IMF EXPECTS GDP GROWTH OF 1.5-2.5 PERCENT THIS YEAR**

The IMF revised its expectations for GDP growth this year to 1.5-2.5 percent, down from previous 4 percent. That forecast takes into account adjusted official figures for Q1 and an estimate of the impact of the floods, which hit the country in late spring.

As regards the GDP data for Q1, the IMF stated that growth did decelerate but the official figure of 3.6 percent decline exaggerates that slowdown. The exaggeration was due to "shortcomings in the method and possibly the data used to calculate GDP and the industrial production index (IPI)".

The IMF pointed out that most of the decline in Q1 could be traced to the closure of one large steel producer. IMF calculations which use a more realistic weight for that producer as well as some other adjustment, indicate that GDP "may in fact have increased moderately in Q1".

#### **COUNTRY RECEIVES FIRST TRANCHE OF PSMAL**

The Ministry of Finance said that the country has received the first tranche worth US\$ 10 million of the World Bank's Public Sector Management Adjustments Loan (PSMAL) to support the budgetary planning and execution.

The Ministry stated "the World Bank is expected to approve the second US\$ 20 million tranche of the US\$ 30 million PSMAL by the end of 2004, upon implementation of all other requirements." Those requirements include control over commitments by budget entities, introduction of new audit and procurement practices, assistance with civil service reform and improving management of expenditures by the social sector.

A WB mission will visit Macedonia on September 27, 2004. The talks will refer mainly to a new loan for reform of the public administration under World Bank's Programmatic Structural Adjustment Loans (PSAL). The Ministry of Finance intends to negotiate start-up of the PSAL from 2005.

#### **DENAR WON'T DEVALUATE**

The denar will not devalue. The Ministry of Finance and the National Bank of Macedonia categorically declared that the new arrangement with the International Monetary Fund would not modify the rate of Macedonia's domestic currency. The devaluation of the national currency was neither requested by the Fund's monetary experts, nor provided in the GOM's agenda for the October negotiations with IMF regarding a new arrangement that would be signed in the upcoming period.

"The denar devaluation issue is not considered at the time being. It is a dangerous move that might distort the system," Deputy Minister of Finance Dimko Kokarovski

declared, after some media informed that IMF will leave Macedonia. According to these media, IMF will accept an eventual arrangement only if Macedonia modifies its denar exchange rate and if the GOM pledges to undertake strong reforms in the upcoming period.

According to Kokarovski, IMF has never conditioned or blackmailed the GOM on certain measures. "We have not received any suggestions for devaluation. We have achieved good results in our budget policy, fiscal consolidation, and foreign exchange reserves amount to US\$ 900 million. These are all good basis for initiating the negotiations for a new arrangement," Kokarovski stressed.

Macedonia's monetary chief, Governor Petar Gosev, categorically stated that the denar will not devalue. "The central bank will sustain in its stable foreign exchange policy, while the new arrangement will focus on deep structural reforms that should lead to greater economic growth and reduction of trade deficit," Gosev said.

In an attempt to convince the Macedonian public that the domestic currency will not devalue, IMF's resident representative to Macedonia, Kevin Ross, stated that the present regime of the denar exchange rate has produced good effects on our macroeconomic policy, overcoming the anticipated expectations. "The present exchange rate regime should not be denounced without close consideration and analysis. We do not intend to change the rate," Ross declared.